

STATE OF MICHIGAN
DEPARTMENT OF ENERGY, LABOR AND ECONOMIC GROWTH
OFFICE OF FINANCIAL AND INSURANCE REGULATION

Before the Commissioner of Financial and Insurance Regulation

In the matter of)
MERRILL LYNCH, PIERCE, FENNER)
& SMITH INCORPORATED,)
Respondent.) ADMINISTRATIVE CONSENT ORDER

WHEREAS, Merrill, Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is a broker-dealer registered in the State of Michigan, with a Central Registration Depository ("CRD") number of 7691; and

WHEREAS, coordinated investigations into Merrill Lynch's activities in connection with its marketing and sale of financial instruments known as auction rate securities ("ARS") to retail and other customers have been conducted by a multistate task force; and

WHEREAS, Merrill Lynch has cooperated with regulators conducting the investigations by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to facts relating to the investigations; and

WHEREAS, Merrill Lynch has advised regulators of its agreement to resolve the investigations relating to its marketing and sale of ARS on the terms specified in this Administrative Consent Order (the "Order"); and

WHEREAS, Merrill Lynch agrees to implement certain changes with respect to its marketing and sale of ARS, and to make certain payments in accordance with the terms of this Order; and

WHEREAS, Merrill Lynch elects to permanently waive any right to a hearing and appeal under the Administrative Procedures Act of 1969, 1969 PA 306, as amended, MCL 24.201 *et seq.* and the Uniform Securities Act of 1964, 1964 PA 265, as amended, MCL 451.501 *et seq.*, and the Rules promulgated thereunder R 451.601.1 – 451.808.8, (the Uniform Securities Act), with respect to this Order; and

1 WHEREAS, solely for the purposes of terminating the multistate task force investigations,
2 including the investigation by the Office of Financial and Insurance Regulation ("OFIR") and in
3 settlement of the issues contained in this Order, Merrill Lynch, without admitting or denying the
4 Statement of Facts and Conclusions of Law contained in this Order, and without an adjudication of any
5 issue of law or fact, consents to the entry of this Order.

6 NOW, THEREFORE, OFIR, as administrator of the Uniform Securities Act, hereby enters this
7 Order:

8 **I.**

9 **STATEMENT OF FACTS**

10 **A. Background Mechanics of Auction Rate Securities.**

11 1. ARS as a general term refers to long-term debt or equity instruments tied to short-term
12 interest rates that are reset periodically through an auction process.

13 2. At auction, ARS always trade at par, with the yield of the instruments being adjusted by
14 the movements of interest rates set by the Dutch auction.

15 3. In the Dutch auction, a security holder had three options, the holder could: (1) hold; (2)
16 purchase or sell; or (3) purchase and hold at rate.

17 4. Investors looking to acquire ARS bid into the auction at the rate and quantity that they
18 were willing to hold the securities.

19 5. Orders for the available quantity of ARS are then filled, starting with the lowest bid rate
20 up until all the shares offered for sale in the auction are allocated.

21 6. The rate at which the final share from the auction is allocated is the clearing rate, and
22 sets the rate to be paid for the entire issue until the next auction.

23 7. If there are not enough purchasers the auction fails, no shares change hands, and the rate
24 resets to a rate that is prescribed in the instrument's offering documents.

25 **B. Merrill Lynch Marketed And Sold Auction Rate Securities As Safe, Liquid Short-
Term Investments.**

26 1. Merrill Lynch Marketed Auction Rate Securities as Safe, Liquid Investments.

1 8. Merrill Lynch marketed and sold ARS as money market like instruments, which were
2 safe and liquid.

3 9. Merrill Lynch additionally used research pieces to market ARS to customers.

4 10. Financial advisers ("FAs") would often forward Merrill Lynch marketing pieces to
5 customers to reassure them of the safety and value of the instruments.

6 11. FAs who sold ARS were not required to provide customers with disclosures, instead
7 customers would receive customer's trade confirmations directing customers to where they could
8 access Merrill Lynch's "Auction Rate Practices and Procedures."

9 12. On March 15, 2006, Merrill Lynch ended its practice of sending ARS purchasers a
10 "Master Purchasers Letter." The Master Purchasers Letter was a disclosure document that all
11 purchasers of ARS had been required to sign and return to Merrill Lynch.

12 13. Merrill Lynch's policies and procedures did disclose some important elements of its
13 ARS program, including that Merrill Lynch plays multiple roles in the ARS market, that Merrill
14 Lynch's interest may differ from those of its clients who purchased ARS, that Merrill Lynch is
15 permitted but not obligated to submit orders for its own account and routinely does, and that a
16 purchaser's ability to sell the purchaser's ARS may be limited.

17 14. Yet, since Merrill Lynch FAs were not required to affirmatively disclose these practices
18 prior to selling a client ARS, purchasers were largely unaware of Merrill Lynch's practices in
19 supporting its ARS program.

20 15. Merrill Lynch did not undertake any analysis of whether any customers actually went to
21 the website discussing its practices and procedures to review them.

22 2. Merrill Used Triple-A Rating as a Selling Point for Auction Rate Securities
23 Even After it had Allowed to Fail Certain Triple-A Rated Auction Rate
24 Securities.

25 16. The fact that its ARS carried a AAA rating was an important marketing point for
26 Merrill Lynch. The AAA rating on ARS was routinely touted in marketing materials, as well as
research pieces that discussed ARS and their safety.

1 17. Marketing materials produced by the ARS desk promoted ARS as follows:

2 • **Auction Market Securities provide many advantages for**
3 **investors**

- 4 • Large and liquid market with over \$306 billion currently
5 outstanding
- 6 • High quality credits with over 92% of the market rated AAA
- 7 • Incremental yield to comparable securities such as commercial
8 paper and money market funds
- 9 • Taxable, tax advantaged and tax exempt investment options

10 18. A triple-A rating is a long-term credit rating.

11 19. The AAA rating on Merrill Lynch's ARS do not speak to an investor's ability to
12 liquidate the instrument through auction at par.

13 20. A number of the collateralized debt obligations and other auction rate securities
14 underwritten and offered by Merrill Lynch carried the AAA rating from major rating agencies.

15 21. In August 2007, as described below, Merrill ceased supporting the auctions of a number
16 of its triple-A rated action rate securities.

17 22. Those securities became illiquid and subsequently lost most of their market value.

18 23. Despite the fact that Merrill had failed a number of triple-A auction-rate securities in
19 August 2007, subsequent to August 2007, Merrill continued to use the AAA rating as a selling point
20 for auction rate securities.

21 24. Merrill Lynch was aware—yet did not disclose to investors—that certain auction rate
22 securities retained their triple-A rating after their auctions had failed.

23 25. Merrill Lynch was aware—yet did not disclose to investors—that the triple-A rating did
24 not provide protection against Merrill deciding to no longer support its auction program.

25 26. Nonetheless, Merrill Lynch relied heavily on the triple-A rating to convince investors
26 the auction rate securities it was selling were safe and principal protected.

1
2 **C. Merrill Lynch's Auction Rate Securities Program Stands in Contrast to its**
3 **Representations to Customers.**

4 1. Merrill Lynch's Auction Rate Program Provided Issuers with Inexpensive
5 Financing and Generated Substantial Fees for Merrill Lynch.

6 27. Merrill Lynch's ARS program was funded by issuers of ARS, who paid Merrill Lynch
7 fees to underwrite securities and remarket them.

8 28. The ARS market allowed issuers to achieve long-term financing at short-term rates.

9 29. The Merrill Lynch ARS program had four branches, an investment bank that
10 underwrote ARS, the ARS desk that acted as a remarketing agent for the securities, a sales force that
11 sold ARS to retail and other clients, and a research division that assisted the ARS desk in placing ARS.

12 30. The ARS that Merrill Lynch underwrote then sold to its clients consisted of auction
13 preferred shares ("APS"), with perpetual maturity, with dividends that reset every 7 to 35 days at
14 auction, or long-term debt instruments, issued by municipalities and student loan organizations with
15 maturities of 20-40 years with interest rates that reset through the same process.

16 31. Due to the upward sloping yield curve, issuers of long-term instruments would typically
17 have to pay higher interest rates.

18 32. By supporting the auction mechanism, both in its role as a remarketing agent and by
19 purchasing ARS at auction to avoid failures, Merrill Lynch allowed issuers to have long-term
20 financing at short-term rates.

21 33. Purchasers of ARS were willing to accept short-term rates because they believed they
22 would have access to their principal on short-term notice at the next auction, and they would get a
23 slightly higher rate than a money market fund because they would have to wait until the next auction to
24 access their money.

25 34. This belief was cultivated by Merrill Lynch and other broker-dealers who used their
26 own capital to ensure auctions did not fail, and generally touted the 20-year track record of very rare
failures, and creating the impression with investors that there was a deep liquid market for the
securities.

1 35. Due to the practice of Merrill Lynch and other broker-dealers of placing support bids,
2 for the 20 years prior to August of 2007 there had been only a handful of failed auctions that prevented
3 investors from accessing their principal.

4 2. Merrill Lynch Generated Significant Fees by Underwriting Auction Rate
5 Securities with Constrictive Maximum Rates and Selling them to Clients.

6 a. Merrill Lynch Generated Significant Fees Underwriting Auction Rate
7 Securities and Distributing Them To Clients.

8 36. The investment bank at Merrill Lynch generated significant fees from underwriting new
9 issuances of ARS. From 2001 through 2008 Merrill Lynch underwrote approximately \$13 billion of
10 APS, earning \$130 million of underwriting fees.

11 37. In order to help move new issues, Merrill Lynch awarded FAs who placed new ARS
12 issues with a placement credits.

13 b. Merrill Lynch Underwrote Auction Rate Securities With Restrictive
14 Maximum Rates, Which Allowed The Securities To Achieve AAA
15 Ratings.

16 38. Upon information and belief 92% of the auction rate securities that Merrill Lynch
17 underwrote received a AAA rating from rating agencies such as Fitch and Moodys, and 97% had
18 ratings of AA or better.

19 39. AAA ratings from agencies such as Fitch and Moodys signify the rating agencies'
20 assessment that there is a high likelihood that the security will pay interest or dividends as well as
21 principal when due in a timely manner.

22 40. Maximum rate provisions place a ceiling on the rate of interest at which an auction can
23 clear, and additionally provide the rate the issuer must pay should auctions fail.

24 41. When evaluating whether an issuer could make payments as due on its ARS, rating
25 agencies would look at the terms of the instrument to determine how much interest it may be obligated
26 to pay. The maximum rate places an absolute cap on the interest or dividend the instrument will pay,
restricting its potential obligations, therefore making it easier for the instrument to achieve a AAA
rating.

1 42. Once Merrill Lynch stopped placing support bids in the auctions for which it was the
2 lead broker-dealer, there were auction failures across its program.

3 43. When auctions fail the rate resets to the maximum rate.

4 44. The ARS with high maximum rates, typically municipal auction rate certificates
5 (“ARCS”) with maximum rates in the range of 12-15%, have drawn investor interest and have cleared
6 without Merrill Lynch’s support.

7 45. The ARS with low maximum rates, typically taxable and tax-exempt APS with
8 maximum rates in the range of 3-5%, have not drawn investor interest and without Merrill Lynch’s
9 support have continued to fail, leaving investors with illiquid instruments.

10 c. Merrill Lynch Additionally Received Fees To Remarket The Auction
11 Rate Securities It Underwrote.

12 46. When Merrill Lynch underwrote an issue of ARS, it typically served as the broker-
13 dealer or remarketing agent for the issue.

14 47. Merrill Lynch would typically receive a fee of 25 basis points of the value of the ARS
15 for which it acted as remarketing agent.

16 48. Merrill Lynch would share a portion of this fee with FAs in order to incentivize them to
17 place clients into ARS.

18 49. Prior to every auction for which Merrill Lynch was the sole or lead broker-dealer,
19 Merrill Lynch would provide “price talk,” a range of bids provided to FAs indicating where Merrill
20 Lynch expected auctions to clear.

21 50. All ARS for which Merrill Lynch acted as sole broker-dealer were placed through
22 Merrill Lynch FAs.

23 51. Under Merrill Lynch’s ARS program, as remarketing agent, the ARS desk had the
24 option but not the obligation to bid in auctions.

25 52. Until August of 2007 Merrill Lynch had a policy of placing support bids into every
26 auction for which it was sole or lead broker-dealer.

 53. In August of 2007 Merrill Lynch withdrew its support for certain CDO-backed ARS.

1 54. When placing a support bid, Merrill Lynch would bid for the entire notional value of the
2 issue being auctioned, regardless of the size or volume of buy, sell, or hold orders Merrill Lynch had
3 received.

4 55. By placing support bids for the entire notional value of the issue being auctioned,
5 Merrill Lynch ensured that no auctions in its ARS program would fail.

6 56. Merrill Lynch often set the rate at which the auctions would clear with its support bids.

7 57. For the period of January 3, 2006, through May 27, 2008, 5892 auctions for which
8 Merrill Lynch was the sole lead dealer would have failed but for Merrill Lynch's support bid.

9 58. Investors were not provided with information about the volume of shares that moved at
10 auction.

11 59. Investors were not provided with information about the level of support from Merrill
12 Lynch that was required to clear the auction.

13 60. Investors were not informed of how many ARS Merrill Lynch was carrying on its own
14 inventory as a result of supporting auctions.

15 **D. Auction Rate Securities Inventory Concerns At Merrill Lynch**

16 1. Weakness in the Credit Markets Initiated Inventory Concerns In Summer Of
17 2007.

18 61. Beginning in late July 2007, certain negative market influences surrounding
19 collateralized debt obligations ("CDOs") and collateralized loan obligations ("CLOs") and a credit
20 crunch began to negatively impact Merrill Lynch's auction market business.

21 62. As investors began selling these ARS due to concerns about their credit quality (despite
22 the fact that many were triple-A rated), Merrill Lynch purchased ARS into its own inventory to make
23 sure those auctions did not fail.

24 63. At a certain point, Merrill Lynch decided to limit the amount of inventory of these
25 instruments it was taking on and ceased submitting support bids, thus allowing the auctions to fail.

26 64. Merrill Lynch FAs began to seek answers to questions concerning ARS as early as
August 7, 2007.

1 65. FAs from all over the United States sent emails and made telephone calls to request
2 information from the Global Markets & Investment Banking staff managing the Merrill Lynch Auction
3 Trading Desk.

4 66. The Auction Desk and the Financial Products Group, along with several of the
5 supposedly independent research analysts for closed-end funds and Fixed Income/Cash, organized and
6 participated in Sales Calls during the second and third week of August 2007 in an effort to clear
7 auctions, reduce the rates of important issuers, and maintain a strong interest in ARS among the Merrill
8 Lynch FAs all over the country.

9 2. Communications With Issuers And Others Expressing Concern About The
10 Auction Markets.

11 67. As early as August 3, 2007, senior management of Merrill Lynch was requesting a
12 sample term sheet for AMPS to understand the liquidity and downgrade risk.

13 68. In August 2007, representatives from major issuers in the closed-end fund investment
14 world were also trying to get a sense of the risks and demand reductions for their preferred shares.

15 69. None of these growing risks concerning weak demand in the ARS market were
16 disclosed to Merrill Lynch clients during the third quarter of 2007.

17 70. Upon information and belief, Merrill Lynch began, in late 2007, discussing with issuers,
18 concerns with the auction markets.

19 3. Merrill Lynch Surpasses Its Inventory Limit In September 2007, As ARS
20 Market Conditions Worsened.

21 71. In late September, inventory levels rose significantly and the Auction Desk was fast
22 approaching its limit of \$1 billion dollars.

23 72. In addition, Merrill Lynch had certain lenders that provided financing for its inventory
24 of auction rate securities.

25 73. Those lenders had previously accepted auction rate securities as collateral for the loans.

26 74. In the Fall of 2007, some of these lenders became uncomfortable with the liquidity of
auction rate securities and ceased accepting them as collateral.

1 75. Merrill Lynch did not inform its retail and other customers, to whom it was marketing
2 auction rate securities as principal protected cash-like instruments, that entities that financed its
3 inventory no longer accepted certain auction rate securities (even some rated AAA) as collateral.

4 **E. Merrill Lynch's Consolidated Effort to Reduce Inventory – A Three Pronged**
5 **Approach.**

6 1. Calming Fears, Providing Assurances And Motivating Additional Sales Of
7 Auction Rate Securities Through Sales Calls with FAs.

8 76. Just after the first hint of investor concern with the auction market, the Auction Desk
9 and Sales and Trading immediately mobilized to stem the tide of negative news. Managers moved
10 quickly to set up sales calls to provide assurances to FAs and to motivate future sales of ARS.

11 77. In late November and early December, with inventory backing up and reaching new
12 highs at Merrill Lynch, a decision was made to do another national sales call. The formula would be
13 similar to the successful call made previously in August. Auction Desk personnel would be joined by a
14 member or members of the Research Department to reassure and motivate FAs to concentrate on
15 selling Auction Desk inventory.

16 78. During the call, there was no discussion regarding the risk of any type of auction
17 failure, or the likelihood or possibility that any market dislocation could result in retail customers' cash
18 becoming illiquid.

19 79. Moreover, there was no discussion about the possibility that Merrill Lynch could decide
20 at any time to stop its support of the auction market or to otherwise withdraw from supporting the
21 auctions that it solely managed or co-managed.

22 80. There was no mention of the fact that with the pressures that existed in the credit market
23 since August 2007, any auction failure by any auction dealer could spread contagion to the rest of the
24 market.

25 2. FA Incentives - Increased Production Credits Sales Drive.

26 81. At various times during the second half of 2007, Merrill Lynch provided incentives in
the form of enhanced production credits as a means of motivating FAs to sell ARS to customers and

1 reduce Merrill Lynch's inventory. Typically, FAs earned 12.5 bps on an annualized basis for
2 investments in ARS. FAs would then earn a percentage of the 12.5 bps according to a payout grid.

3 82. During periods where enhanced credits were awarded, FAs could earn as much as 8
4 times that amount (or 100 bps) for sales of ARS. Other enhanced payouts could include payouts of 25
5 bps, or 50 bps. Similar to regular production credits earned, FAs enhanced production credits would be
6 applied to the grid resulting in FAs being paid a certain predetermined percentage of the enhanced
7 production credit.

8 3. Coordination with Research

9 a. Proactive Involvement From The Supposedly Independent Research
10 Department To Aid In Sales Efforts.

11 83. Merrill Lynch's Research Department played a pivotal role in assisting sales of Auction
12 Rate Securities.

13 84. On at least two occasions during the Fall of 2007, Sales and Trading and the Auction
14 Desk made direct and specific requests for the Research Department to draft favorable research pieces
15 regarding the auction market to assist in Sales.

16 b. Improper Information Sharing –Between Research and Sales and
17 Trading.

18 85. The task force's investigation revealed frequent communications among research, sales,
19 and trading staff.

20 86. Merrill Lynch Policy & Procedures Manual (the "Policies Manual") employs a so-
21 called "Chinese Wall," which is designed to prevent "the misuse of material non-public information"
22 and to prevent "even the appearance of impropriety."

23 87. The "Chinese Wall" is designed to "restrict and monitor the flow of information
24 between the various areas of [Merrill Lynch] such as Global Research, Sales [and] Trading," among
25 others "to avoid the misuse of such information and the appearance of impropriety as well as to
26 manage potential conflicts of interest..."

1 88. Among those departments that constitute the "Private Side of the Wall" include:
2 "Investment Banking, including Global Capital Markets and Financing (Equity Capital Markets and
3 Debt Capital Markets)," and "other departments or individuals that regularly receive inside
4 information," while the Research Division is on the "Public Side of the Wall."

5 89. Among the categories of information that cannot be discussed between Sales or Trading
6 and Research are the levels or amounts of inventory that Merrill Lynch maintained for its own account.

7 90. Such information was discussed.

8 **F. Improper Influence And Pressure Over Supposedly Independent Research**
9 **Personnel.**

10 91. Merrill Lynch permitted its Sales and Trading and Auction Desk personnel to have
undue influence over its Research Department regarding its coverage of the auction market.

11 92. In addition to the direct requests of Sales and Trading and the Auction Desk to Research
12 for positive published material related to the auction market, undue influence was also exercised over
13 the content of the published research reports.

14 93. Other times, Auction Desk Personnel attempted to directly influence how Research
15 responded to FA questions during sales calls.

16 **G. Events Leading To Merrill Lynch's Decision To Stop Broadly Supporting Its**
17 **Auction Program.**

18 94. Concerns surrounding the auction market grew more ominous going into the new year
19 and Merrill Lynch's Auction Desk personnel began to brace for the worst.

20 95. Likewise, Inventory concerns at Merrill Lynch continued.

21 96. On January 23, 2008, word began circulating among broker-dealers that Lehman
22 Brothers had a number of auctions fail the previous day.

23 97. Concerns were not shared with FAs or retail customers.

24 98. Between the dates February 1, 2008 and February 8, 2008, staff wrote or contributed to
25 approximately three published research pieces, including: Fixed Income Digest, "Preserve Income
26 Lock in Yields"; Fixed Income Digest Supplement, "Auction Market Securities" and Auction Market

1 Value Sheet, "Back to Basics In The Auction Market." Each of these publications continued to
2 recommend that investors should feel confident about the auction market.

3 99. On or about February 1, 2008, Merrill Lynch's Research Department published a
4 volume of its Fixed Income Digest, entitled "Preserve Income Lock in Yields." The cover page
5 included a section entitled "Preserve Income." The last sentence of the section provided: "For funds
6 that investors need to keep liquid, we continue to find the best value in auction market securities."
7 Inside the research piece, there was a subheading: "For Cash Holdings: auction market securities,"
8 which recommended, [n]aturally, most investors need to keep some portion of their portfolios in liquid
9 cash-like instruments. We find auction market securities (AMS) to be better alternative than money
10 funds for these purposes for investors with larger amounts to invest." The section was followed
11 immediately by another section dedicated to: "Answering Your Questions About Auction Market
12 Securities" which responded to common questions relating to the auction markets at the time.

13 100. On February 4, 2008, the Research Department re-published the "Answering
14 Questions" piece on its own as a supplement to the Fixed Income Digest in part, because of questions
15 the Research Department was getting calls and that FAs were likely having a problem locating the
16 information in the otherwise lengthy February 1, 2008 publication.

17 101. On the evening of February 12, 2008, Merrill Lynch executives decided to cease
18 supporting its auction rate securities program and intentionally allowed the vast majority of their
19 auctions to fail the following day.

20 102. Merrill Lynch's decision to stop broadly supporting its auction program was made
21 without any real consideration or analysis of its effect on retail and other investors holding the
22 securities.

23 **H. Merrill Lynch Has Marked Down Its Own Inventory of Auction Rate Securities,**
24 **But Still has Not Marked Down The Estimated Value Of The Auction Rate**
25 **Securities On Its Clients' Account Statements.**

26 103. Merrill Lynch has marked down the value of its own inventory of auction rate
securities, yet has not marked down the value of those same auction rate securities in its client
statements.

104. According to client statements received by the task force, auction rate securities listed on client statements have not been marked down to reflect their illiquidity. Their "estimated market value" is still listed as 100 percent of par. Certain of the exact same instruments held by Merrill Lynch in its inventory have been marked down from par.

II.

CONCLUSIONS OF LAW

1. OFIR has jurisdiction over this matter pursuant to the Uniform Securities Act.

2. The above conduct violates: (1) Section 204 of the Uniform Securities Act, MCL 451.604(a)(1)(g) for dishonest or unethical practices, and (2) Section 204 of the Uniform Securities Act, MCL 451.604(a)(2) for failure to reasonably supervise its employees and/or agents.

3. OFIR finds the following relief appropriate and in the public interest.

III.

ORDER

On the basis of the Statement of Facts, Conclusions of Law, and Merrill Lynch's consent to the entry of this Order,

IT IS HEREBY ORDERED:

1. This Order concludes the investigation by OFIR and any other action that OFIR could commence under the Uniform Securities Act on behalf of the State of Michigan as it relates to Merrill Lynch, relating to the marketing and sales of ARS by Merrill Lynch, provided however, that excluded from and not covered by this paragraph 1 are any claims by OFIR arising from or relating to the "Order" provisions contained herein.

2. This Order is entered into solely for the purpose of resolving the referenced multistate investigation, and is not intended to be used for any other purpose.

3. Merrill Lynch will CEASE AND DESIST from violating the Uniform Securities Act and will hereafter comply with the Uniform Securities Act.

4. Merrill Lynch shall pay \$125 million (the “Settlement Payment”) to the Commonwealth

1 of Massachusetts and the other states, which shall be allocated at the Commonwealth of Massachusetts
2 and the other states' discretion, to resolve all underlying conduct relating to the sale of auction rate
3 securities. Merrill Lynch shall pay \$3,095,319.80 of the Settlement Payment to the State of Michigan,
4 allocated in the following manner: \$2,785,787.82 to the State of Michigan General Fund, and
5 \$309,531.98 to the Michigan Investor Protection Trust Fund. In the event another state securities
6 regulator determines not to accept Respondents' settlement offer, the total amount of the payment to
7 the State of Michigan shall not be affected, and shall remain at \$3,095,319.80.

8 5. Definitions and Buyback Offer. Merrill Lynch will provide liquidity to Eligible
9 Investors by buying Eligible Auction Rate Securities that have failed at auction at least once between
10 February 13, 2008, and the date of this Offer, at par, in the manner described below.

11 "Eligible Auction Rate Securities," for purposes of this Order, shall mean auction rate
12 securities publicly issued by municipalities or closed-end funds or backed by student loans and
13 purchased at Merrill Lynch on or before February 13, 2008. Notwithstanding any other provision,
14 Eligible Auction Rate Securities shall not include privately issued or placed auction rate securities that
15 are unregistered and/or offered pursuant to SEC Rule 144A, or other exemptions of the Securities Act
16 of 1933.

17 "Eligible Investors," for purposes of this Settlement, shall mean:

18 (i) Natural persons (including their IRA accounts, testamentary trust and estate accounts,
19 custodian UGMA and UTMA accounts, and guardianship accounts) who purchased Eligible Auction
20 Rate Securities at Merrill Lynch:

21 (ii) All small business and not for profit clients in Merrill Lynch's Global Wealth
22 Management Group who purchased Eligible Auction Rate Securities at Merrill Lynch that had \$100
23 million or less in assets in their accounts with Merrill Lynch, net of margin loans, as of August 7,
24 2008, or, if the customer was not a customer of Merrill Lynch as of August 7, 2008, as of the date that
25 the customer terminated its customer relationship with Merrill Lynch. Notwithstanding any other
26 provision, "small business and not for profit clients" does not include broker-dealers or banks acting as
conduits for their customers.

1 6. Tranche I Eligible Investors. No later than September 26, 2008, Merrill Lynch shall
2 have offered to purchase at par, plus any accrued but unpaid interest or dividends, Eligible Auction
3 Rate Securities for which auctions are not successfully auctioning from Eligible Investors who had less
4 than \$4 million in assets at Merrill Lynch as of August 7, 2008. Merrill Lynch's offer to purchase such
5 securities from Eligible Investors will remain open from October 1, 2008 through January 15, 2010,
6 and Merrill Lynch shall promptly purchase such securities from any Eligible Investor who accepts this
7 offer between January 2, 2009 and January 15, 2010.

8 For purposes of this Settlement, legal entities forming an investment vehicle for closely related
9 individuals, including but not limited to IRA accounts, Trusts, Family Limited Partnerships and other
10 legal entities performing a similar function, charities and non-profits, and small businesses who had
11 less than \$4 million in assets at Merrill Lynch shall be covered by Section III.5(i).

12 7. Tranche II Eligible Investors. No later than December 18, 2008, Merrill Lynch shall
13 have offered to purchase at par, plus any accrued but unpaid interest or dividends, Eligible Auction
14 Rate Securities from other Eligible Investors who purchased Eligible Auction Rate Securities from
15 Merrill Lynch prior to February 13, 2008, and who had less than \$100 million in assets at Merrill
16 Lynch as of August 7, 2008.

17 Merrill Lynch's offer to purchase such securities from Eligible Investors shall remain open
18 from January 2, 2009 through January 15, 2010, and Merrill Lynch shall promptly purchase such
19 securities from any investor who accepts this offer between January 2, 2009 and January 15, 2010.

20 8. Asset Amounts. Merrill Lynch shall calculate investor asset amounts as of August 7,
21 2008, for all Eligible Investors with assets with Merrill Lynch as of that date. For Eligible Investors
22 with no assets at Merrill Lynch as of that date, Merrill Lynch shall calculate investor asset amounts as
23 of the date such investor removed their assets from Merrill Lynch.

24 9. Notice and Assistance. Merrill Lynch shall provide prompt notice to customers of the
25 settlement terms, and Merrill Lynch shall establish a dedicated telephone assistance line, with
26 appropriate staffing, to respond to questions from customers concerning the terms of the settlement.

1 10. Relief for Eligible Investors Who Sold Below Par. No later than October 1, 2008, any
2 investor covered by Section III.5 that Merrill Lynch can reasonably identify who sold Eligible Auction
3 Rate Securities below par between February 13, 2008 and October 1, 2008, shall be paid by Merrill
4 Lynch the difference between par and the price at which such investor sold the Eligible Auction Rate
5 Securities.

6 11. Consequential Damages Claims. No later than October 1, 2008, Merrill Lynch shall
7 make reasonable efforts promptly to notify those Eligible Investors covered by Section III.5 above who
8 own Eligible Auction Rate Securities, pursuant to the terms of the settlement, that an independent
9 arbitrator, under the auspices of the Financial Industry Regulatory Authority (FINRA), shall be
10 available for the exclusive purpose of arbitrating any Eligible Investor's consequential-damages claim.
11 Merrill Lynch shall consent to participate in the North American Securities Administrators
12 Association's ("NASAA") Special Arbitration Procedures (the "SAP") established specifically for
13 arbitrating any Eligible Investor's consequential damages claim arising from their inability to sell
14 Eligible Auction Rate Securities. Nothing in this Offer shall serve to limit or expand any party's rights
15 or obligations as provided under the SAP. Arbitration shall be conducted before a single non-industry
16 arbitrator and Merrill Lynch will pay all forum and filing fees.

17 Arbitrations asserting consequential damages of less than \$1 million will be decided through a
18 single chair-qualified public arbitrator who will be appointed through the FINRA list selection process
19 for single arbitrator cases. In arbitrations where the consequential damages claimed are greater than or
20 equal to \$1 million, the parties can, by mutual agreement, expand the panel to include three public
21 arbitrators who will be appointed through FINRA's list procedure.

22 Any Eligible Investors who choose to pursue such claims through the SAP shall bear the
23 burden of proving that they suffered consequential damages and that such damages were caused by
24 their inability to access funds invested in Eligible Auction Rate Securities at Merrill Lynch as of
25 February 13, 2008. In the SAP, Merrill Lynch shall be able to defend itself against such claims;
26 provided, however, that: Merrill Lynch shall not contest liability for the illiquidity of the underlying

1 ARS position or use as part of its defense any decision by an Eligible Investor not to borrow money
2 from Merrill Lynch. Special or punitive damages shall not be available in the SAP¹.

3 All customers, including but not limited to Eligible Investors who avail themselves of the relief
4 provided pursuant to this Order, may pursue any remedies against Merrill Lynch available under the
5 law. However, Eligible Investors that elect to utilize the SAP are limited to the remedies available in
6 that process and may not bring or pursue a claim relating to Eligible Auction Rate Securities in another
7 forum.

8 12. Institutional Investors Not Covered By Section III.5. Merrill Lynch shall endeavor to
9 continue to work with issuers and other interested parties, including regulatory and other authorities
10 and industry participants, to expeditiously and on a best efforts basis provide liquidity solutions for
11 investors who purchased Eligible Auction Rate Securities from Merrill Lynch and are not entitled to
12 participate in the buyback described in Section III.5 above (referred to herein as "Institutional
13 Investors").

14 Beginning January 2, 2009, and then quarterly after that, Merrill Lynch shall submit a written
15 report to a representative specified by NASAA outlining the efforts in which Merrill Lynch has
16 engaged and the results of those efforts with respect to Merrill Lynch Institutional Investors' holdings
17 in Eligible Auction Rate Securities. Merrill Lynch shall confer with the representative no less
18 frequently than quarterly to discuss Merrill Lynch's progress to date. Such quarterly reports shall be
19 submitted within 20 days following the end of each quarter and continue until no later than January 15,
20 2010. Following every quarterly report, the representative shall have the option of requiring a meeting
21 between the State and Merrill Lynch to advise Merrill Lynch of any concerns and, in response, Merrill
22 Lynch shall detail the steps that Merrill Lynch plans to implement to address such concerns. The
23 reporting or meeting deadlines set forth above may be amended with written permission from the
24 representative.

25 ¹ However, it is agreed by the parties that "consequential damages" shall have a meaning separate and apart from
26 "punitive or special damages." Under no circumstances should this provision be read to mean that a consequential damages
claim may not be maintained due to any state law which may categorize consequential damages as a subset within punitive
and/or special damages.

1 13. Relief for Municipal Issuers. Merrill Lynch shall refund refinancing fees to municipal
2 auction rate issuers that issued such Eligible Auction Rate Securities in the initial primary market
3 through Merrill Lynch between August 1, 2007 and February 13, 2008, and refinanced those securities
4 through Merrill Lynch after February 13, 2008. Refinancing fees are those fees paid to Merrill Lynch
5 in connecting with a refinancing and are exclusive of legal fees and any other fees or costs not paid to
6 Merrill Lynch in connection with the transaction.

7 14. No Disqualification. The Order entered pursuant to this Offer hereby waives any
8 disqualification contained in the laws of the State of Michigan, or rules or regulations thereunder,
9 including any disqualifications from relying upon the registration exemptions or safe harbor provisions
10 that Merrill Lynch or any of its affiliates may be subject to. The Order entered pursuant to this Offer
11 also is not intended to subject Merrill Lynch or any of its affiliates to any disqualifications contained in
12 the federal securities laws, the rules and regulations thereunder, the rules and regulations of self
13 regulatory organizations or various states' or U.S. Territories' securities laws, including, without
14 limitation, any disqualifications from relying upon the registration exemptions or safe harbor
15 provisions. In addition, this Order is not intended to form the basis for any such disqualifications.

16 15. Nothing herein shall preclude the State of Michigan, its departments, agencies, boards,
17 commissions, authorities, political subdivisions and corporations (collectively, "State Entities"), other
18 than OFIR and only to the extent set forth in paragraph 1 above, and the officers, agents or employees
19 of State Entities from asserting any claims, causes of action, or applications for compensatory, nominal
20 and/or punitive damages, administrative, civil, criminal, or injunctive relief against Merrill Lynch in
21 connection with certain auction rate securities sales practices at Merrill Lynch.

22 16. For any person or entity not a party to the Order issued pursuant to this Offer, this Offer
23 and the Order do not limit or create any private rights or remedies against Merrill Lynch including,
24 without limitation, the use of any e-mails or other documents of Merrill Lynch or of others for auction
25 rate securities sales practices, limit or create liability of Merrill Lynch, or limit or create defenses of
26 Merrill Lynch, to any claims.

 17. In Consideration of the Settlement OFIR will:

1 a. Except as allowed by paragraph 17(b), terminate the investigation by OFIR and any other
2 action that OFIR could commence on behalf of the State of Michigan as it relates to Merrill Lynch's
3 underwriting, marketing, and sales of Eligible Auction Rate Securities, provided, however, that
4 excluded from and not covered by this paragraph are any claims by OFIR arising from or relating to
5 the "Order" provisions contained herein.

6 b. Refrain from further investigation and from taking legal action, if necessary, against
7 Merrill Lynch with respect to Institutional Investors until a date after December 31, 2009.

8 c. Not seek additional monetary penalties from Merrill Lynch relating to the issues raised
9 by OFIR relating to Merrill Lynch's marketing and sale of Eligible Auction Rate Securities to
10 investors and the firm permitting trading in auction rates securities by any individuals affiliated with
11 Merrill Lynch.

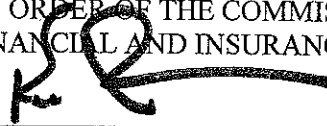
12 18. Failure to Comply With Terms of Settlement. If after this settlement is executed,
13 Merrill Lynch fails to comply with any of the terms set forth herein, OFIR may vacate this Order, at its
14 sole discretion, upon 10 days notice to Merrill Lynch and without opportunity for administrative
15 hearing or may refer this matter for enforcement as provided in the Uniform Securities Act.

16 19. This Order and any dispute related thereto shall be construed and enforced in
17 accordance with, and governed by, the laws of the State of Michigan without regard to any choice of
18 law principles.

19 20. This Order shall be binding upon Merrill Lynch and its successors and assigns as well
20 as to successors and assigns of relevant affiliates with respect to all conduct subject to the provisions
21 above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions,
22 events, and conditions.

23
24
25 Dated this 27th day of June, 2009.
26

1
2 BY ORDER OF THE COMMISSIONER OF THE OFFICE OF
3 FINANCIAL AND INSURANCE REGULATION



4 Ken Ross, Commissioner
5 Office of Financial and Insurance Regulation
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1 **CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY MERRILL LYNCH**

2 Merrill Lynch hereby acknowledges that it has been served with a copy of this Administrative
3 Consent Order ("Order"), has read the foregoing Order, is aware of its right to a hearing and appeal in this
4 matter, and has waived the same.

5 Merrill Lynch admits the jurisdiction of OFIR, neither admits nor denies the Statement of Facts
6 and Conclusions of Law contained in this Order; and consents to entry of this Order by OFIR as
7 settlement of the issues contained in this Order.

8 Merrill Lynch agrees that it shall not claim, assert, or apply for a tax deduction or tax credit
9 with regard to any state, federal or local tax for any administrative monetary payment that Merrill
10 Lynch shall pay pursuant to this Order.

11 Merrill Lynch states that no promise of any kind or nature whatsoever was made to it to induce it
12 to enter into this Order and that it has entered into this Order voluntarily.

13 Teresa M. Brenner represents that he/she is _____ of Merrill Lynch and that, as
14 such, has been authorized by Merrill Lynch to enter into this Order for and on behalf of Merrill Lynch.

15 Dated this 10th day of June, 2009.

16
17 MERRILL LYNCH, PIERCE, FENNER & SMITH
18 INCORPORATED

19 *Teresa Brenner*

20 By: Teresa M. Brenner
 Title: Associate General Counsel

21 STATE OF NORTH CAROLINA, COUNTY OF MECKLENBURG

22 SUBSCRIBED AND SWORN TO before me this 10th day of June, 2009.

23 *James E. Dwiggins*

24 Notary Public James E. Dwiggins

25 My Commission expires:
26 May 02, 2010

